wireless costs should determine wireless support. I have not seen a demonstration that wireless carriers in high-cost areas are, in fact, the same areas as high-cost areas for the incumbents. In fact, I think that quite possibly some of the urban areas are, in fact, higher cost areas for wireless carriers than rural areas. So, I think we need really need to have to a demonstration of where the costs are a barrier to achieving comparable services at comparable rates. And then that should be the basis for support.

I think we should also not mistake the intense competition for revenues and minutes for competition between the services. There is relatively little competition directly between wireless and wireline service for access. And, in fact, they are complementary to a great extent. In answer to the point raised about whether wireless carriers take as much out of the funds as they put into it, one the benefits wireless consumers get is the ability to reach anybody on a wireline phone by using their wireless service. And that was achieved largely through our universal service policies that built out the wireline network to reach everyone. So, they are benefitting even if they are not getting the same number of dollars out of the fund as they put in.

And, finally, I'd make two notes. One of them is that to the extent that there are allegations that the rural incumbents are inefficient, grossly inefficient, to me, that undermines any last reason why we should have equal support. I mean, presumably, if money is being wasted by the incumbents, why does a wireless carrier need the same amount of waste in order to compete? They simply don't have to waste it to begin with.

And the other point I'd make is that there is a sense of competitive sense of neutrality that is important and that has already come to past. And that is the competitive neutrality among wireless carriers themselves. We have a rural area in Alaska now where there are three wireless ETCs along with the wireline ETC. And it seems to me if you're going to provide high-cost support to one wireless carrier, you pretty much have to provide it to all, because they are competing directly for the same customers. And that, I think, enlarges the fund considerably.

COMMISSIONER ABERNATHY: Thank you very much.

Now, we'll hear from Dr. Lee Selwyn.

DR. SELWYN: Thank you, Commissioners. Glad to be back on this panel. I appreciate the opportunity to speak with you on this subject.

I was reviewing the statutory language and the statute that we've been talking about. The statutory language, let me just read it again: that customers in rural high-cost areas shall have access to telcommunications and information services that are reasonably comparable to those services provided in urban areas.

That to me implies that the policy that the Commission has been pursuing for 30-some-odd-years now of encouraging the development of competition, the policy that was adopted by Congress in the '96 Act, in looking to competition to support the telcommunications demands of this country, cannot be distinguished between non-rural and rural areas. If you develop and maintain a support system that in some manner limits the opportunities for consumers to benefit from competition in rural areas, then the statutory mandate is not being fulfilled.

Now, that said, let me speak about a couple of the specifics that are being discussed. First of all, let's talk for a minute about the equal support rule. My belief is that the equal support rule is absolutely essential to assure that consumers are confronted with efficient choices between and among various providers and various technologies.

Now, I actually find myself in agreement up to a point, which perhaps is unusual, with Dr. Lehman, as to the idea of carrying inefficiencies over from rural ILECs into CETCs. And the solution to that is to use as the basis for support the cost level of the most efficient provider. So, if the CETC is able to do it cheaper than the rural carrier -- or the rural ILEC than it is the CETC's cost and not the rural ILEC's costs that provide the basis for funding. So, we eliminate your concern about inefficiency and we eliminate my concern about a lack of competitive neutrality.

CETCs are carriers-of-last-resort. There is no proposal out there that suggests that any competitor that happens to wander into a particular rural community is immediately entitled to high-cost support. Carriers have to comply with the requirements of certification as ETCs, which includes a commitment to serve their communities ubiquitously. If multiple CETCs and multiple wireless carriers are certified as ETCs, that doesn't necessarily expand the size of the fund since the funding would be based upon the number of lines provided by each carrier. So, if three carriers divide up the wireless segment of the market, then the total draw would be essentially the same.

If you provide differential support based upon each carrier's costs or each technology's cost, you distort consumer choice, you distort investment choice. You discourage entry by lower cost -- inherently lower cost providers who are being forced to compete with subsidized higher-cost companies. That denies those customers in those communities access to competitive service.

Finally, on the issue of whether or not wireless and wireline are the same, first of all, the Commission, I think, needs to be consistent. If intermodal competition is to be viewed by the Commission as a general matter, as demonstrating the presence of competition in a market -- and certainly this has been raised in other areas in section 271 cases and the triennial review among other places, in broadband proceedings -- then you can't simply decide that oh, gee, in rural areas it's a different story.

Now, are they perfect substitutes? Absolutely not. No question about it. But they are economic substitutes and there is a price at which a consumer -- a price differential at which a consumer may be indifferent as between one or the other. If a price of a wireline service is $100 a month and then the price of a wireless service is $20 a month or $30 month, then there will be consumers who while preferring wireline service might decide at that point that the preference isn't worth the price difference. And that's exactly the kind choices we want consumers -- we want to encourage consumers to make. If we distort those choices by subsidizing wireline service to the tune of the difference between 100 and 30, that choice is eliminated.

No one is saying they are the same service, but they are at a certain level economic substitutes. And if intermodal competition is going to be a focus of Commission policy, you can't change the rules, as it were, in rural areas. It seems to me that rural, in order to establish a level playing field, to encourage efficiency, to eliminate the various perverse incentives in the present system that looking to provide an equal level of support for carriers based upon the most efficient carrier's costs is a reasonable policy approach. Thank you.

COMMISSIONER ABERNATHY: Thank you very much, Dr. Selwyn.

And now we'll move to the Q and A, we

will start with Commissioner Martin.

COMMISSIONER MARTIN: Mr. Johnson, I heard you state a -- I think I heard you state a fact that I wanted to follow up on. You said that 80 percent of the growth in the high-cost fund was not a result of CTEC growth. Is that -- could you --

MR. JOHNSON: That's correct. If you remember when we re-balanced rates, moved things from implicit cost to explicit cost, there was a dramatic increase in the high-cost fund. Since that was completed, however, something like 83 percent of the growth has been from CETCs. The fact is that for the last, I think, two years the total growth in the high-cost fund from incumbents is something like 3.1 percent.

COMMISSIONER MARTIN: And no one on the panel disagrees with that?

MR. JOHNSON: That's based USAC's numbers.

MR. COLE: I agree. The numbers that I used were 22 million and 110. And that is from 2003 to 2005 the projection by USAC. And some of the numbers have been used in the earlier time period. But if look at the growth between 2003 and 2005 projected, using USAC numbers, you look at the high-cost loop fund, it is basically the same percentage. 83 percent is the increase driven by CETCs.

MR. BERGS: I have to plead partial ignorance and then a little disagreement. I've got to admit, I don't know if we look at only the last two years. But if we looked at 2000 and 2003, 87 percent of the growth in the fund was attributable to ILECs.

MR. JOHNSON: That's correct. As I said, that was the period of time when we re-balanced rates and moved things specifically into the ICLS rates.

COMMISSIONER MARTIN: And then my next question was for Dr. Selwyn. I agree with you that the Commission ultimately has to be consistent in its approach on intermodal competition. I mean, that's an important point as we're trying to figure out how we're approaching this. And you're right, that has been raised in a series of proceeding including the TRO.

But it has also been raised in some

of the mergers that we've had in front us recently. And in that context, I think we've actually been more skeptical in our conclusions about the current substitutability of wireless per wireline service. So, does that have an impact in your comments today?

DR. SELWYN: In fairness I, myself, have been skeptical about the substitutability. So that nobody goes -- and I'm sure there will be people here who would go and try to dig out my prior testimony and say, see, he's being inconsistent. As I said, they are not perfect substitutes. But at a certain point they are economic substitutes.

I think that in particular in rural areas where we are confronting unusually -- what are alleged, at least, to be unusually high costs for wireline services, wireless may be a more viable technical economic substitute than in other areas. And we certainly want to encourage the exploitation of that technology if, in fact, that is true.

And then the last thing we should be doing is distorting that or discouraging investment. So, I absolutely agree that we are -- I don't believe they are perfect substitutes. I don't believe the market has -- in the mainstream market, despite attempts by certain incumbent LECs to portray it otherwise, I don't think the mainstream market has made that demonstration. But in particular in rural areas, the potential for -- as an alternative, as a lower cost alternative is real and certainly should not be distorted. And that's all I'm saying.

COMMISSIONER MARTIN: Thank you.

COMMISSIONER ABERNATHY: Commissioner Dunleavy.

COMMISSIONER DUNLEAVY: Thank you, Madam Chair.

Ms. Parrish, if we base the CETCs support on its own costs, are we assuming or just hoping those costs are lower than the ILEC's costs?

MS. PARRISH: Well, our proposal to base is its on own costs up to the amount of the ILEC costs. So, it would -- the support would also always be lower than or equal to that of the ILEC. I don't think you can assume that it's always going to be higher or lower. It's that it's going to depend on the area; it's going to depend upon the density and the build-out. It's that they have some of the same density issues that the wireline carriers do.

And, in fact, if you -- the other concern I have is that some of the suggestions that have been made that we base it on the model of the lower of the costs, whether it's wireline or wireless, is that I think that again goes to the issue of build-out and assuring that the build-out built in the model is sufficient to actually serve the entire service area. Because if you use the actual construction that's out there now, you might not actually be supporting enough coverage based on some of the wireline model descriptions.

COMMISSIONER DUNLEAVY: And one little follow-up. When you're talking about support of customer lines, you're talking about the primary line or all lines?

MS. PARRISH: Either way. I think -- because the model's generally built to a household, and the addition of one line or two lines in terms of the cost models doesn't make very much difference. Now, what we're seeing in terms of the current system where you have -- it's based strictly on the number of lines and the ported amount from the incumbent is you're seeing three and four lines in a household being supported, and that clearly doesn't have the cost basis because you don't have four times the cost to serve a household as you do for serving one. I mean, the math doesn't work. You don't multiply by four for every line into that same household.

COMMISSIONER DUNLEAVY: That being the case, how do we reconcile that? Do we need Mr. Johnson's workshops and teach people how to do that?

MR. JOHNSON: Well, I think you do. I think if you're going to take public money and if you have an obligation to provide a level of service that says that it's good public policy -- that you get public money to do that, then I think we have to develop a methodology for insisting that people justify what they're doing with the public money. If that means we have to develop workshops as a way of doing it, put the safe harbor plan in place that we recommended, first to allow that to happen so we can kind of stop this thing from growing any larger right now, yes. This is not easy, but it's doable. And it's a lot easier than a lot of things I have to deal with every day.

COMMISSIONER DUNLEAVY: Go ahead, Mr. Bergs.

MR. BERGS: I would just add that some of the proposals that you've heard today are that we ultimately move the support to an individual. In that environment that problem is solved, especially when the lowest cost provider sets the basis for the per customer support. At that point, you aren't concerned about overfunding either of the two carriers that's available.

And I'd just add -- and this kind of ties into this question as well as one of your earlier ones -- that even assuming that the growth in the fund has been of a result of the competitive ETCs in the last year, to distort that number, ultimately -- again, a customer is only going to have so many connections.

We're not going to end up in an environment where there is an unlimited number connections for every person in those high-cost areas. So, there's an inherit cap with the current mechanism if we base it on per lines. By allowing that, the only way to fund growth is in that environment. Once we have established a competitive environment and are funding the most efficient provider, is it more people move to those rural areas? I think most of us would agree that might be a good thing.

COMMISSIONER DUNLEAVY: Does anyone have a specific idea of how we verify that?

MS. PARRISH: Well, I mean, I can't lay out the details for you, but I think that one of our ideas is you have to look at affordability and comparability. And comparability, we've started looking at on a state level where you might have a $40 cellular phone bill that includes lots of bells and whistles. And to try and get it down to the comparable price of plain, old dial tone, you, you know, take $3 off for call waiting and $5 off for voice mail and so forth. And then you can start doing an apples to apples comparison of at least what the prices of those services are. And I think that you have to assume that there's some relationship between price and cost.

COMMISSIONER ABERNATHY: With regard to the growth of the fund being related to the CETCs, of course, it is because they didn't exist before. So, that's no great surprise. It doesn't really concern me, because they didn't exist before and so it would make sense that as we decided to embrace competition for rural America that in fact that would drive up the size of the fund.

The real question for me is, are we directing the funds in the right way at the right amounts? And as Ms. Parrish said earlier, I think instead of focusing on carriers with high costs, I think our focus should be on consumers in high-cost areas. And in some respects I think we would want to embrace lower cost technology, not embrace higher cost technology.

And so, that leads to me see if anyone wants to comment on one of the proposals that's been out there, which is you basically seek out a bid to serve that area and the one with the lowest cost bid -- this is what a number of developing countries are doing -- the one that comes in and says, I will serve this for the least amount of the subsidy, that's then what any provider gets who serves that area.

I've heard concerns about that, that, well, what about the folks who entered under the old regime and they're there and they've got embedded costs. But I'd like to hear some debate around that proposal.

DR. LEHMAN: I'm not sure what people would be choosing between. I mean, what kind of service are they going to get? They like their cell phone. They use it a lot of the time. They can't use it in their rural residence because the service doesn't reach there. So, when you face them with this choice and take the lowest bid, how are you going to educate them as to exactly what it is that they're getting for that choice?

COMMISSIONER ABERNATHY: Well, you have to have certain criteria that any vendor would have to meet. And we'd certainly addressed that, I think, at the FCC and in the Joint Board when we said, if you want to be an ETC, you have to have carrier-of-last-resort, you'd have to have certain obligations. So, I think you -- you'd have certain criteria that would have to be met.

So, let's assume for a minute that the technology -- let's say it's not wireless, it's some other technology. Assume that it could do that. Is this overall approach reasonable?

DR. LEHMAN: The house I used to live in in a rural area, you could not have gotten a bid from other than the existing wireline provider if you required that they provide service to my home. Now, that's not the way the current rules read. If you're going to write rules that say you must be able to provide this level of quality of service to where the person's residence is and it must work X percent of the --

COMMISSIONER ABERNATHY: ILECs today only have to serve based upon reasonable request. Even the incumbents don't have to serve anyone. So, you'd have the same test for the new provider.

Gene, do you want to talk about this or Scott?

MR. JOHNSON: Well, I'm just thinking about we have to be careful that we don't dismantle this marvelous telephone system we have in this country to do that. So, I'm a potential competitor and I come in say, you know, put out the bid in the area that you live in, your study area, I guess, that I'm going to bid to do this. And so now, maybe I already have a network in place; maybe I don't. But to be sure, the network probably is not as good as the existing network that's there. If that was true, we'd be losing customers right and left to wireless carriers that we're not. And I think that's probably true in general in rural communities. It's not like in urban communities where you're losing customers to wireless carriers. It's a secondary service not replacing the primary service.

So, the concern I would have is as they build this out, when do you cut the -- I have a lot of concerns, obviously -- but when do you cut the funding out to me? I've got embedded costs. I've got this compact I've entered into with regulators that's 100 years or more old, certainly goes back into the '30s. And all of a sudden you're going to pull this compact out and say, we're just going to leave you stranded. Well, what happens to my stranded investment when you do that in these variable areas?

And at the end of the day, more importantly, what happens to the rural customers when the company that won the bid doesn't perform? You see construction projects every day that are taken over my by a bonding company at great delay and cost many times to the owner because the low cost bidder just was not able to perform.

MR. BERGS: Actually, I agree with a portion of what Mr. Johnson said. I think that in a bid proposal what the Commission would in essence be doing is picking a point in time and identifying the most efficient carrier at that point in time. Maybe most efficient isn't even the right characterization. The provider who will generate the most value to the customer at that point in time.

And today, I believe in a lot of our areas, we are that carrier. It may be a slightly biased opinion, I admit. But I do expect that at some point in time another technology, either provided by us or another carrier is going displace CMRS technology as the most efficient. I'm afraid the bid proposal would limit the ability of new technologies to be easily entered into those high-cost areas.

However, if competition under the current mechanism is in place and portability is in place, customers will choose the most high-value service available in that market, thereby alleviating the need for the bid proposal. It will target support to the most high-value provider.

COMMISSIONER ABERNATHY: Okay. And then one quick follow-up is if -- let's assume for a second this approach can't work because of the distortions and you've got the incumbents with other prices and we said, all right, we're not going to try this bid proposal. We're going to continue to have ETCs, but we're going to ask them to somehow justify their support through some kind of proceeding. If we came up with a new way of justifying support, wouldn't it make sense then to apply it to all the carriers who are serving that area if you came up with a better way? That was our first panel. It was really how you figure out the amount of support. It sounds to me like it might be whatever methodology you come up with, you would apply it to both the new guys coming in as well as the incumbents. Does that make sense?

MR. JOHNSON: I think that's what we said in our filing is that we think essentially what is good for the goose is good for the gander. We believe the right way to do that right now is based on embedded costs, so we would suggest that the CETCs submit appropriate kinds cost models or cost studies of some kind, perhaps if there are average schedule type costs that could be developed in order to do that. We absolutely agree with that.

MR. COLE: I guess one of the things Mr. Bergs talked about, I think you mentioned also in the start of yours as far as not focusing on the company, focus on the people involved. And it may be a given, but just a moment to visit. I think it is important. I understand the purpose of the universal service fund is -- what it was meant to do versus what we may be doing now.

And I just happened to think while I was sitting in the back a while ago. I went to my parents' this weekend with my seven-year-old, just to take her there. And they live in a very rural area, much of what we're talking about. It's actually a CenturyTel area. I believe it does receive USF support. I went there and it's easier to visit my parents, and they live across the street from my grandparents, and my sister lives next door. And they live in several little houses right at the top of the hill. And they're probably the only houses within a mile of there. And you go past there about 50 feet and the road stops and you have dirt. And then there's about one house per mile after that.

But I think we talked about what has

changed since then. I remember when I was a seven-year-old and went up there and my grandparents were across the street. That was my first introduction to phone service. And I learned real quickly when the phone rang, and their house was no bigger than this area up here, that there was two different rings. When one of them rang, it was your grandparents and you answered the phone and said, hello. And when it was the other ring, it was her mother-in-law, my great-grandparents across the street. And when it rang, you just picked up real quietly and didn't say anything and handed it to your grandmother. That was my introduction to telephone service and party lines and what it is.

And then I go there this weekend and, you know, we've long ago done away with party lines. We have single party, all digital service in that area. My father has his Internet hooked up to our telco service and has that. I look at the things that universal service means for that community. They now have one-party service. They really couldn't have had that without that. They now have 9-1-1. The biggest challenge with 9-1-1 was not the technology, but it was coming up the a name for all the roads. So, we did that.

And then we had an ice storm there five years ago. We were able to stay in touch, but they were out of electricity for five years (sic). So, those are the kinds of things I want to talk about when you think about universal service.

At the same time, my father has a bag phone, a wireless phone that he's had for ten years. It's the same bag phone and I know I should have bought him one by now, but he's stuck on that bag phone. And so, he's had that same service for ten years. He can't really use it at home. He has to use it in the car between the old saw mill after the turn. He goes there and he can pick up service and between Monroe. But he could not use that as a substitute for his home.

However -- and that's where the struggle is because, again, assuming that there is a wireless ETC there, I'm not sure that it's not going to have the